Department of Revenue Washington State

Excise Tax Advisory

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AT&T Services, Inc. v. Department of Revenue

Purpose

The purpose of this ETA is to explain the effect of the Thurston County Superior Court's order in *AT&T Services, Inc. v. Department of Revenue* (*AT&T Services*), which invalidated portions of WAC 458-20-19402 (Rule 19402) for tax periods before June 12, 2014. The court entered its order on May 24, 2021.

Background

Washington adopted single factor receipts apportionment effective June 1, 2010. Former RCW 82.04.462(3)(b) (2010) provided that, for purposes of calculating a taxpayer's receipts factor, gross income from apportionable activities is attributable to the state:

(i) Where the customer received the benefit of the taxpayer's service or, in the case of gross income from royalties, where the customer used the taxpayer's intangible property.

(ii) If the customer received the benefit of the service or used the intangible property in more than one state, gross income of the business must be attributed to the state in which the benefit of the service was primarily received or in which the intangible property was primarily used.

The statute lists additional cascading steps that apply if the taxpayer is unable to attribute gross income under subsections (3)(b)(i) or (ii).

The Department adopted Rule 19402 interpreting this statutory language. Rule 19402 provided guidance that under subsection (3)(b)(i) of the statute, if a customer received the benefit of a service in multiple states and can reasonably determine the amount of apportionable receipts related to the benefit received in this state, such amount must be attributed to this state. This may be shown by applying a reasonable

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method of proportionally attributing the benefit among states ("proportional attribution").

Effective June 12, 2014, the legislature amended RCW 82.04.462(3)(b)(i) to explicitly allow for proportional attribution.[1]

Summary of *AT&T Services*

AT&T Services involved a taxpayer challenge to Rule 19402 in the Thurston County Superior Court. The taxpayer argued that, by requiring proportional attribution for tax periods prior to June 2014, Rule 19402 exceeded the Department's rule-making authority.

- On May 24, 2021, the Superior Court ruled that Rule 19402 is invalid to the extent it requires taxpayers to use proportional attribution for tax periods before June 12, 2014.
- The Department did not appeal the Court's order in *AT&T Services*.
- The order does not impact Rule 19402 for periods on or after June 12, 2014.

Effect of *AT&T Services*

As a result of the *AT&T Services* decision, a taxpayer may qualify for a refund if it meets all the following criteria:

1) The taxpayer used proportional attribution, as instructed by Rule 19402, when calculating its receipts factor for periods before June 12, 2014,
2) This calculation resulted in overpayment of taxes for the relevant period(s), and
3) The taxpayer submits a refund application within the nonclaim period (see "Nonclaim Period" below).

Nonclaim Period

The Department cannot provide a refund or credit for taxes paid more than four years before the beginning of the calendar year in which:

- a refund application is made, or
- examination of records by the Department is completed,

unless the taxpayer and the Department have agreed to extend this time period (contact the Department regarding the process for extending this period). For more information see RCW 82.32.060 and WAC 458-20-229.

[1] This amendment added the following language to subsection (3)(b)(i): "When a customer receives the benefit of the taxpayer's services or uses the taxpayer's intangible property in this and one or more other states and the amount of gross income of the business that was received by the taxpayer in return for the services received or intangible property used by the customer in this state can be reasonably determined by the taxpayer, such amount of gross income must be attributed to this state." The amendment also provided language specifying that subsection (3)(b)(ii) applies if the taxpayer is unable to attribute gross income under subsection (3)(b)(i).

Assessments for additional tax due must be made within four years after the close of the calendar year in which the tax was incurred, except:

- Against a taxpayer who was not registered as required by chapter 82.32 RCW,
- Upon a showing of fraud or misrepresentation of a material fact by the taxpayer, or
- Where the taxpayer executed a written waiver of this limitation. See RCW 82.32.050 and WAC 458-20-230.

In addition, when the Department accepts a taxpayer's timely petition for informal administrative review, the nonclaim period at issue in that review remains open pending the Department's decision.

Determining whether Overpayment Occurred

A taxpayer has overpaid if the amount of B&O tax actually paid on apportionable income for pre-June 12, 2014 periods exceeds the amount that would have been due based on a receipts factor that does not use proportional attribution.

Discovery of Underpayment

In some circumstances, recomputing the receipts factor without using proportional attribution will result in a tax underpayment. In those circumstances, the Department may issue a tax assessment for the underpaid amount if the nonclaim period is still open.

Application of Cascading Steps for pre- June 12, 2014 Periods

This section explains how the cascading steps apply to tax periods from June 10, 2010 to June 11, 2014, without using proportional attribution.

As codified in 2010, RCW 82.04.462(3)(b) provided that, for purposes of calculating the receipts factor, gross income from each apportionable activity is attributed based on a series of cascading steps. Consistent with *AT&T Services*, for pre-June 12, 2014 periods, gross income is attributed to the state:

(i) Where the customer received the benefit of the taxpayer's service or, in the case of gross income from royalties, where the customer used the taxpayer's intangible property.

Subsection (3)(b)(i) applies when the taxpayer's records establish that apportionable income can be tied to a specific customer that received the benefit of the taxpayer's service (or used the taxpayer's intangible property) in a single state.

In addition, when the taxpayer's records establish that specific revenue streams making up apportionable income from the customer can be tied to either specific

benefits received in a state, or specific use of intangible personal property in a state, then subsection (3)(b)(i) applies to each revenue stream.

If specific revenue streams cannot be clearly tied to specific benefits or uses of intangible property, and subsection (3)(b)(i) otherwise does not apply without using proportional attribution, then the taxpayer must use subsection (3)(b)(ii) if applicable. Subsection (3)(b)(ii) provides:

> (ii) If the customer received the benefit of the service or used the intangible property in more than one state, gross income of the business must be attributed to the state in which the benefit of the service was primarily received or in which the intangible property was primarily used.

If the taxpayer is unable to attribute gross income using subsection (3)(b)(i) or (ii) then gross income is attributed using (3)(b)(iii) or a subsequent cascading step. *AT&T Services* does not affect the application of subsection (3)(b)(iii) and subsequent steps.

Examples: Application of Cascading Steps for pre-June 12, 2014 periods

The following examples identify several facts and then state a conclusion. These examples should only be used as a general guide for applying the cascading steps in RCW 82.04.462(3)(b) as codified in 2010. The tax results of other situations must be determined after a review of all the facts and circumstances.

Note: These examples apply the cascading steps for pre-June 2014 periods without using proportional attribution. To determine whether an overpayment of tax occurred, the taxpayer must:

- Calculate the receipts factor and tax that would be due based on the cascading steps in pre- June 12, 2014 under RCW 82.04.462(3)(b)(i) through (vii), and
- Compare that amount to tax actually paid on apportionable income.

Example 1

Facts:

- Franchisor enters into a licensing agreement with Franchisee for periods including June 1, 2010 through June 11, 2014. The licensing agreement allows Franchisee to operate three restaurants using Franchisor's branding and other intellectual property. Franchisee's restaurants are located in Washington, Oregon, and Idaho.
- Under the licensing agreement, Franchisor receives a fee based on 15% of Franchisee's monthly sales from each restaurant.

Result:

- In this case, the licensing agreement clearly ties Franchisor's 15% of monthly sales income to each restaurant where the customer, Franchisee, uses its intellectual property. The first cascading step, subsection (3)(b)(i), applies separately to Franchisor's revenue streams from each restaurant.
- Applying subsection (3)(b)(i), Franchisor's 15% of sales income from the Washington restaurant is attributed entirely to Washington.
- Using the same analysis, Franchisor's revenue streams from the Oregon and Idaho restaurants are attributed to Oregon and Idaho respectively.

Example 2

Facts:

- Ad Agency provides marketing services to Software Developer from January to December 2013. Ad Agency's services involve the creation of a national marketing campaign to promote a newly released line of software that Software Developer recently started distributing at retail stores nationwide.
- Ad Agency is paid a flat fee for its services according to a service agreement. The flat fee is paid upon Ad Agency's completion of the national marketing campaign.
- Software Developer negotiates and executes the service agreement with Ad Agency from Software Developer's office in California.

Result:

- The documentation is insufficient to tie specific revenue streams making up Ad Agency's gross income to specific benefits received by the customer, Software Developer. This is because Ad Agency's flat fee is based on the completion of the nationwide marketing campaign. Ad Agency is unable to attribute its income under subsection (3)(b)(i).
- Ad Agency is also unable to attribute its income under subsection (3)(b)(ii). The facts do not indicate that the benefit of the service is primarily received in a state.
- Ad Agency must apply subsection (3)(b)(iii) and attribute its income to California, where Software Developer negotiated and executed the service agreement. This is considered where the customer ordered the service.

Example 3

Facts:

- Investment Manager provides fund management services to its affiliate Broker for periods including June 1, 2010 through June 11, 2014. Broker has offices in numerous states where it solicits individual clients to invest in a private equity fund.

- Broker pays Investment Manager a monthly fee based on a percentage of the value of assets in the fund.
- There is no singular office from which Broker orders the service from Investment Manager. The contract between Broker and Investment Manager instructs Investment Manager to perform the requested services at its various offices across multiple states.
- Investment Manager sends billing statements for its services every month to Broker's headquarters in Ohio.

Result

- Investment Manager is unable to tie specific revenue streams making up its gross income to specific benefits received by its customer, Broker. This is because Investment Manager's service fee is based on the value of assets in the fund and cannot be further separated. Investment Manager is unable to attribute its income under subsection (3)(b)(i) based on where benefit of the service is received.
- Investment Manager is unable to attribute under subsection (3)(b)(ii). There is no indication that the benefit is primarily received in a single state.
- Investment Manager is also unable to attribute under subsection (3)(b)(iii). There is no single "state from which the customer ordered the service" in this case.
- Investment Manager must apply subsection (3)(b)(iv) and attribute its income to Ohio, the state where it sends billing statements to Broker.